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International Economic & Energy Weekly

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30 March 1984

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30 March 1984

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Synopsis

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International Economic & Energy Weekly

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Perspective

Andropov's Economic Legacy

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Chernenko inherits the same set of economic problems that plagued Andropov, who laid only tentative groundwork for future changes in economic policy. 25X1

Andropov's accomplishments were modest. Although his discipline campaign apparently spurred improved efforts from both management and labor, it was soon toned down, and its long-term effects are uncertain. New personnel have been placed in governmental and party ranks, but whether they are more innovative than their predecessors remains to be seen. Moreover, the head of the ministerial bureaucracy is still Nikolay Tikhonov—an old crony of Brezhnev—who seems hardly the candidate to sanction, much less inspire, a fresh approach to economic problems. In the pivotal area of correcting systemic weaknesses, there is little evidence that Andropov's early call to explore the experience of other socialist countries bore much fruit. 25X1

Andropov probably deserves some of the credit for the moderate acceleration in Soviet GNP last year. His emphasis on discipline and order, in addition to management changes in critical sectors such as transportation, apparently paid off in the better use of industrial capacity, improved coordination in planning material supplies, and eased bottlenecks. Other key growth factors were not of his making. Improved weather helped both industry and agriculture, and investment growth substantially exceeded plan as it had done in the previous two years. Such increases have been in direct violation of the spirit and letter of the 11th Five-Year Plan (1981-85), which decreed low rates of investment growth to be compensated for by rising capital productivity. 25X1

The economic plan for 1984 afforded Andropov an opportunity to place his unique stamp on future Soviet economic policy. He did not. In the domestic area, his strategy for production and resource allocation in 1984 hews close to the pattern of growth achieved in 1983. In foreign economic policy, the objective stated in the 1981-85 Plan continues to be followed—increased trade with Communist countries at the expense of trade with the West. 25X1

Pursuing such a course has meant that the Soviet leadership continues to avoid a direct confrontation with the hard economic issues of the 1980s:

- *Slow Growth*. By maintaining the fiction that GNP growth can be sustained by unrealistically high productivity gains, Moscow implies that adequate growth is ensured for consumption, investment, and defense.

- *Capital Productivity.* An investment policy of equipment modernization is at variance with the failure to grant necessary resources to the machine-building sector or to provide adequate incentives for the introduction of new technologies.
- *Labor Productivity.* Calls for greater efficiency from the Soviet worker are not backed up by strong, well-defined programs that dangle the carrot or wield the stick.
- *Bottlenecks.* Programs to deal with priority areas such as energy, transportation, and consumer goods contain solutions that are neither bold nor new. Moreover, they are built on the present ministerial system—a serious obstacle to solving problems that cut across sectoral lines.
- *Economic Reform.* Admission that the present system of planning, organization, and incentives is inadequate for spurring intensive growth is followed by changes that continue to be incremental and experimental.
- *Defense Burden.* Despite a slowdown in the growth of resources devoted to the military since the mid-1970s, the burden of defense is still high—13 to 14 percent of GNP. The evidence suggests that the Soviets are determined to bear this heavy burden throughout the 1980s. 25X1

The reasons for this conservatism probably lie in the leadership's perception that the costs of pursuing a more dynamic economic policy outweigh the benefits. Economically, they see few clear-cut, risk-free, or costless solutions. Politically, they know that setting a different set of economic priorities threatens to upset the always fragile balance between competing groups and institutions. 25X1

Andropov, then, as Brezhnev before him, left a legacy of stunted potential for the Soviet economy. Chernenko faces slow growth and low efficiency for the rest of this decade if present policies are maintained. His initial speeches and comments as General Secretary have stressed continuity with Andropov's policies. His past record suggests that he may take a more proconsumer stance and deemphasize the discipline theme (although so far he has endorsed both the discipline and anticorruption campaigns). Even if he decides that he wants to do things differently, the impact will not be immediate. Politically, it will take some time to consolidate power; economically, relatively long lead-times are needed to accomplish major shifts in resource allocation. 25X1

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Briefs

Energy

Iraqi Attack on Oil Tanker

[redacted]

The Greek company Ceres Hellenic Shipping Enterprises, owner of the 85,000-dwt oil tanker Filikon L., confirmed that the vessel was struck by an unidentified missile early on 27 March at a location approximately 100 km south-southwest of Khark Island. The company claimed the missile put a 20-inch hole about 6 feet above the waterline on the starboard side of the ship, damaging the number-four hold, which is leaking fuel oil. Apparently there was no explosion, and none of the 26 crewmembers was injured. According to a source of the American Embassy in Kuwait, the ship, chartered by the Kuwait Petroleum Corporation, had departed Kuwait's Mina al Ahmadi oil export terminal earlier in the day, bound for Sicily with a cargo of 80,000 tons of fuel oil. The Embassy source indicates the vessel may be heading to Dubayy for repairs. ([redacted] 25X1 25X1

Officials in Baghdad claimed that Iraqi Super Etendard aircraft destroyed two "large naval targets" on 27 March in the Iraqi-proclaimed exclusion area southwest of Khark Island. The broadcast, however, made no mention of the use of an Exocet missile in the attack on the ships. In air activity farther north, Baghdad claimed to have bombed a pumping station near the town of Dezful, apparently on the 750-km-long Trans-Iranian Pipeline, which carries crude oil from Ahvaz north to Tehran. [redacted] 25X1

Iraqi Oil Pipeline Negotiations

[redacted]

Iraq's concern about the financing and security of the proposed oil pipeline through Jordan apparently is causing a shift in favor of the alternative pipeline through Saudi Arabia. The US Interests Section in Baghdad says that discussions on the proposed pipeline from Iraq to Al Aqabah, Jordan, have stalled because of Baghdad's resistance to asking Saudi Arabia and Kuwait to provide guarantees for the financing. Without such guarantees, other private financers of the pipeline will back out. Iraq also is insisting on US Export-Import Bank financing and US assurances that Israel will not interfere with the pipeline. Baghdad has implied it will abandon the Jordanian project if its conditions are not met. [redacted] 25X1 25X1

[redacted] 25X1

[redacted] 25X1

Kuwaiti Proposal To Use Tapline

[redacted]

Kuwaiti oil officials have begun to look into the feasibility of using excess capacity in Tapline, the trans-Arabia crude oil pipeline linking Saudi Arabia's eastern oilfields to the Mediterranean at Sidon, Lebanon. [redacted] 25X1 25X1 Due to damage to the export terminal and sections of pipe in Lebanon, the Lebanese and Syrian portions of Tapline have been abandoned, although approximately 40,000 b/d is still being sent through the line to Jordan from Saudi Arabia. Under current Saudi planning, this supply would cease in 1986 when Aramco intends to use the southern portion of Tapline for other purposes. The remaining Saudi section of the line, however, would still be available to carry Kuwaiti oil to the vicinity of Jordan's Az Zarqa refinery, where it would be transferred to the Iraqi pipeline for throughput to the Red Sea. Although still in a formative stage, the scheme could finally give Kuwait an alternative to exporting oil via the Persian Gulf. Tapline's original capacity was 500,000 b/d, and, although cannibalization and removal of pumps have apparently cut this by about half, we believe the pipeline probably could again handle this volume of oil if the pump stations were restored. [redacted] 25X1

Algeria Maneuvers To Step Up LNG Exports

[redacted]

The Algerian natural gas monopoly SONATRACH last week asked US banks involved in financing Algerian LNG facilities to press the Trunkline natural gas company to honor its LNG contract with SONATRACH. SONATRACH claims that it cannot meet its annual debt service of $210 million on LNG facilities and tankers if Trunkline does not resume at least part of its liftings. 25X1 Trunkline purchased $380 million in Algerian LNG in 1983 before suspending purchases last December. If Trunkline does not resume liftings, SONATRACH probably will request restructuring the US-bank portion of its LNG-related debts and a three-year payment moratorium. [redacted] 25X1

International Finance

Jamaican Progress Toward IMF Agreement

[redacted]

Prime Minister Seaga told US Embassy officials last week that Jamaica and the IMF have completed negotiations for an $70 million standby loan. He said that a conditional letter of intent will be formally signed within two weeks, after the IMF observes the new foreign exchange auction in operation. The US 25X1

Embassy reported that the auction system worked as intended last week—its first week of operation—resulting in an 8-percent devaluation of the Jamaican dollar. The IMF loan still has to be approved by the Board of Governors, so funds will not be disbursed until late May at the earliest. 25X1

Jamaican officials now are seeking rapid disbursement of loans that have been withheld pending the IMF agreement. In particular, they have approached Embassy officials regarding the remaining $25 million of a US emergency loan and plan to seek disbursal of a $25 million IBRD structural adjustment loan. Seaga stressed the urgent need for these funds, indicating that some of Jamaica's commercial bank loans are approaching default because Kingston has not made interest payments for nearly 90 days. 25X1

Mexican Bridge Loan for Costa Rica

Mexico has loaned Costa Rica the $50 million that San Jose has claimed is necessary to avert imminent technical default on its foreign bank debt. This bridge loan is scheduled to be repaid by mid-June, according to the US Embassy. Mexico, which wants to avoid problems with its own creditors, has insisted that its support not be publicized. Although Mexico City has long 25X1 insisted that its economic aid is not politically motivated, this loan may be intended to restore the appearance of fairness because other Central American countries are aware of Mexico's substantial aid to Nicaragua. The loan probably will allow Costa Rica to make payments on commercial loans for the next few months, but one US bank believes that it will merely delay a foreign exchange crisis until midsummer. Costa Rica has reached preliminary agreement with the IMF on a standby loan for this year, but the IMF probably will provide only half the credit it did last year. 25X1

Kuwait Clamps Down on Moneychangers and Exchange Houses

Kuwait's Ministry of Finance is prohibiting moneychangers and exchange houses from trading foreign currencies on behalf of banks abroad and from engaging in domestic banking activities. The new restrictions are a belated attempt to rein in Kuwait's freewheeling financial system and to curb capital flight. Some Embassy sources believe that Kuwaitis used the exchange houses to move currency abroad after the 1982 collapse of the Suq al-Manakh, the 25X1 unofficial stock market. According to local press reports, the government wants to eliminate the widespread practice by moneychangers of purchasing dollars from Kuwaiti banks and then selling them for a profit to offshore banks in Bahrain. The government also wants to stop moneychangers and exchange houses from competing with local commercial banks. These traditional institutions have long been used by Kuwaitis to perform banking functions, such as receiving savings deposits, issuing letters of guarantee, and extending credit. 25X1

Global and Regional Developments

Zaire and Zambia Set New Cobalt Price

Zaire and Zambia, which together account for roughly 60 percent of world cobalt output, recently announced a new producer price of $11.70 per pound. The action probably was taken to stem the rapid rise in cobalt prices and to give a sense of order to the market. In recent weeks, cobalt has traded as high as $12.60 per pound on the spot market, about double its average price at the beginning of this year. We believe the new price is high enough to assure both countries adequate profits while being low enough to discourage new cobalt mine startups and to head off a new round of substitution and conservation measures similar to those that followed the dramatic price runups of 1978 and 1979. 25X1 25X1

The rapid rise in cobalt prices is apparently due to several factors. The near-term supply situation is tightening as Zaire and Zambia begin initial shipments of high-grade cobalt to the US Government stockpile. Between the two countries, nearly 3,000 tons of cobalt—about one-tenth of world output—are to be delivered this year. Output from the Philippines, Australia, and Canada—where cobalt is produced as a byproduct—has fallen as a result of cutbacks in nickel production. Due to improved business conditions, cobalt demand in the developed countries has picked up considerably over the past few months. Rumors of large purchases by the USSR and Eastern Europe have no doubt contributed to speculative buying as well. Although temporary shortages of high-grade cobalt may exist, producer stocks are plentiful. At current non-Communist consumption rates, Zaire alone has at least a year's supply on hand. Belgian metal traders are also believed to be holding sizable cobalt stocks of Zairian origin. 25X1

Sweden-USSR Trade Commission Meets

Swedish and Soviet officials held annual trade talks this week amid troubled relations resulting from suspected Soviet submarine intrusions, the expulsions of three Soviets last year, and the USSR's attempts to secure computer technology through Sweden. The US Embassy in Stockholm says the Swedes are seeking assurances that trade will be based solely on economic considerations. They also want to improve economic and technological cooperation and to reduce their persistent trade deficit resulting from large imports of Soviet oil. 25X1 25X1

Despite efforts by senior members of Prime Minister Palme's government to revive trade in 1983, economic relations are likely to remain depressed. The Soviets recently rejected a Swedish firm's bid for work in the Tallinn Port expansion project, a move Stockholm believes was in retaliation for Swedish firmness. The Swedes probably will reject proposals to extend a Soviet gas pipeline from Finland to Sweden's east coast. The USSR presumably is content with its favorable balance of trade with Sweden, and Stockholm admits it has no specific proposals to offer that would be economically attractive to Moscow. 25X1

Austria Wants To Expand Trade With the Soviet Bloc

Austrian officials and businessmen are making new efforts to expand exports to the Soviet Bloc. Austria reduced its trade deficit with the East last year by more than half, largely because of a 13-percent jump in exports. US officials in Vienna note, however, that the 1983 export total includes completion of a number of long-term projects and that export growth is expected to decline in 1984. Possibly to counter this development, the Federal Chamber of Commerce recently briefed a group of Austrian commercial attaches assigned to East Bloc countries on plans to expand Austrian exports to the region. Measures include selecting new commodity groups to penetrate CEMA markets, scheduling scientific and technological conferences, and recruiting experienced East-West traders to help small and medium-sized firms. 25X1 25X1

CEMA nations provide an important outlet for certain Austrian industries, especially the troubled traditional sectors such as machinery and iron and steel. The Austrians sell approximately two-thirds of their grain, over one-fifth of their footwear, and about one-third of their iron and steel products in the East, and gains in exports in 1983 came primarily in these areas. Austrian officials probably hope that their newer industries can maintain export growth to the CEMA countries and thus pay for energy imports, nearly half of which come from the East. 25X1

National Developments

Developed Countries

Early Israeli Elections

An early elections bill received preliminary Knesset approval last week after one of the small parties in the ruling coalition joined the opposition Labor Party in support of the measure. TAMI Party leader Abuhatzeira said he supported early elections because of the inflation rate—prices rose at an annual rate of 354 percent during the first two months of the year—and the need for a government with a more decisive mandate. The bill has gone to the Likud-controlled constitution and law committee, which will set the election date and return the bill to the full Knesset for three mandatory votes. Prime Minister Shamir has said he will respect the decision of the Knesset and will not try to bury the bill in committee. 25X1 25X1

The parties are now maneuvering over when the elections will be held. Shamir wants to delay the elections as long as possible—preferably until November—because he believes the economy will improve by fall. Labor Party Chairman Peres—with support from TAMI—wants an election called for 22 May to forestall a challenge over party leadership from former Prime Minister Rabin and possibly former President Navon. Peres also wants to prevent the Likud from introducing popular economic measures before the election as it did in 1981. 25X1

Australian Budget Strategy

After a "Camp David"–style strategy meeting in mid-March, the Hawke government appears headed for a moderately expansionary budget for the fiscal year that begins 1 July. The principal element of the budget is a cut in personal income tax rates designed to placate organized labor, which has been demanding such a move in return for its continued support of Hawke's wage indexation scheme. The tax cuts will probably take effect in October or November, early enough to boost Hawke's chances at the polls if, as we expect, he calls early elections for late this year or early 1985.

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Despite the tax cuts, we believe strong economic growth will boost revenues, trimming the deficit. Still, government leaders are worried that this will do little to ease pressures on interest rates, which have increased 3 to 4 percentage points since December, a trend that ensures more political maneuvering on the budget in the months ahead.

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Belgium Plans Greater Austerity

The Social Christian–Liberal coalition plans to cut the budget deficit from 13 percent of GNP in 1983 to 7 to 8 percent in 1986. The government seeks widespread expenditure cuts, including decreases in cost-of-living adjustments to public- and private-sector wages and most social security benefits. Prime Minister Martens agreed not to raise taxes to gain the support of his Liberal coalition partners. The government plan to limit the growth of its wage bill over the next three years through job sharing, part-time work, attrition, and the adoption of a 38-hour workweek is an attempt by Martens to reconcile the deflationary aspects of the budget with Belgian's high unemployment—which topped 12 percent in 1983.

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The US Embassy reports generally favorable business reactions. The opposition socialist parties and the socialist unions, however, term the plan antilabor and a violation of a government promise made last September not to demand cuts from the public sector in 1984 and 1985. At that time, Brussels was seeking an end to wildcat public-sector strikes. The US Embassy also reports that the Socialist Labor Federation has announced a protest action for 3 April. Nonetheless, we believe most Belgian workers will conclude that they have little choice but to accede to the government's new wage adjustment and job-sharing proposals. The success of the austerity plan, however, will require sustained economic growth to bolster government revenues.

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Less Developed Countries

Brazil's Underground Economy Booming

Brazil's growing underground economy is blunting some discontent with austerity but is posing new difficulties for compliance with the IMF agreement. According to the Brazilian Institute of Geography and Statistics, the underground economy—transactions outside formal channels of taxation and government control—grew to a record $17 billion in 1983, about 6 percent of Brazil's measured GDP last year, up from 1 percent in 1980. Although the

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government is concerned, Brasilia is unlikely to adopt widespread reforms to curb the underground economy. Nearly 10 million people—equivalent to 20 percent of the work force—derive some income from the underground economy, softening the impact of austerity on living standards. These "off-record" transactions, however, reduce tax collections and circumvent government controls necessary to ensure compliance with the IMF agreement. In the heavily industrialized state of Rio de Janeiro alone, officials estimate that 10 to 15 percent of the state's 1983 GDP was produced in the underground sector, causing a loss of more than $400 million in tax revenue. [redacted] 25X1

Mexico Announces Divestiture of Private Company Shares

[redacted] 25X1

Mexico City is slowly clarifying plans to divest shares in over 300 companies acquired when the banks were nationalized in late 1982. According to US Embassy reporting, treasury officials briefed business representatives privately and have given them six weeks to review the government's offer. Press and Embassy reporting indicate the former bank owners will be given first chance to repurchase company stock, then present majority stockholders will have an opportunity to buy the shares. In cases where the government owns less than 15 percent of a firm's stock, shares probably will be sold directly on the stock market. Although Mexico City did not identify the 128 firms whose stock the government plans to retain, press sources speculate they will include the bank's real estate, credit analysis, and credit card subsidiaries. The private sector views the disposition of company shares as a key indicator of de la Madrid's attitude toward business; a successful transfer will help restore business confidence. [redacted] 25X1

The Philippines Faces Uncertain Oil Supply

[redacted] 25X1

Increasing evidence suggests that Manila's financial problems are affecting its ability to import oil:

- Manila's oil supply contracts with one of its largest suppliers, Kuwait, elapsed in December, and negotiations to renew them have been stalled because of Kuwaiti objections to Philippine requests for special credit arrangements.

[redacted] 25X1

- Although supplies from Saudi Arabia are not in jeopardy, the Saudis have refused recent Philippine requests for extended repayment terms.
- Traders are avoiding spot sales to the Philippines because the Philippine National Oil Company is demanding lengthy repayment terms and will not guarantee payment in dollars. [redacted] 25X1

Government stocks, although low, have not required rationing. [redacted] 25X1 As Manila's financial crisis drags on, however, we believe suppliers will become even more reluctant to offer extended credit arrangements,

particularly while Manila seems incapable of reaching quick agreement with the IMF. According to US Embassy reporting, Indonesian President Soeharto has already parried a request from President Marcos to provide oil to the Philippines on a 180-day deferred payment basis. [redacted] 25X1

Syrian Foreign Exchange Crunch Hits Major Suppliers

[redacted]

Syria has missed payments to the USSR and Iran—its most important suppliers—because of continuing foreign exchange shortages. According to a US Embassy report, Syria now owes Iran at least $400 million for oil shipments. According to the same report, Syria did not have the necessary foreign exchange for an unspecified downpayment—due in January—on three TU-154 passenger aircraft from the Soviet Union. [redacted] 25X1 25X1

Damascus will probably be able to convince both Tehran and Moscow to continue credit sales to Syria. Tehran, anxious that Assad continue to prevent Iraqi oil from transiting the pipeline through Syrian territory, will probably agree to longer payment periods. Early last year, the Iranians forgave Syria's oil debt, yielding Damascus the equivalent of at least $750 million in aid. Moscow initiated the aircraft deal and therefore would probably prefer to reach an accommodation with Syria rather than see the arrangement collapse. [redacted] 25X1

Ethiopian Economic Problems

[redacted]

Addis Ababa is facing growing hard currency shortages and a worsening drought. The recent harvest and already-promised food aid probably will cover food requirements in government-controlled areas of the country at least until November, but continued scant rains will worsen prospects for the main grain crop, to be planted in May or June. Continued large trade deficits and reduced capital inflows have pushed foreign exchange reserves down to only two weeks' worth of imports, according to the US Embassy. The government is scrambling to ease its cash crunch by issuing unbacked checks to foreign suppliers of luxury goods and delaying the deposit of funds sent to resident foreign personnel and organizations. Although Addis Ababa undoubtedly hopes that traditionally high second-quarter coffee earnings will relieve the cash shortage, we think the government will have to resort to additional stopgap measures, reduce planned imports, and press the Soviet Union for additional economic assistance; eventually, they may still have to approach the IMF for payments support. [redacted] 25X1

Southern African State Budgets

[redacted]

Recently announced budgets for Botswana, Lesotho, and Swaziland reflect efforts to control expenditures in the wake of drought and other natural disasters and their continued dependence on the South Africa–backed Southern African Customs Union (SACU) for revenues. Payments from SACU are 25X1

about 60 percent of Swaziland's total revenues, 50 percent for Lesotho, and 30 percent for Botswana:

- Swaziland's budget was presented last month but already is being revised because of the recent typhoon damage to transport and agriculture. Lacking new revenue sources, the deficit will be considerably larger than anticipated, according to the US Embassy; the government probably will attempt to increase its foreign borrowing.

- Lesotho is trying to reduce its foreign commercial borrowing and retire some outstanding debts in response to an IMF recommendation in November 1983. Sharply increased SACU revenues—anticipated this year from temporary South African customs surcharges—represent an extraordinary "windfall" that, according to the IMF, would allow this corrective action. Although austerity measures have reduced planned expenditures slightly in real terms in fiscal year 1984, actual spending could run much higher because of continuing drought and political pressures prior to the national elections announced for this year.

- Botswana's government revenues have been boosted by increased tax receipts from diamond sales—the country's major export—and higher SACU receipts. This will allow a 5-percent real growth in planned expenditures. Three years of severe drought have made water projects and drought relief major budget items that could necessitate additional, unbudgeted expenditures. 25X1

Zimbabwe Puts Limits on Capital Outflows

The government has announced major restrictions on foreign payments in the face of foreign exchange shortages after suffering a current account deficit of about $450 million last year. The remittance of rents and dividends on foreign investments made in Zimbabwe before 1979 has been suspended for at least one year. Some $180 million in foreign securities held by commercial banks in Zimbabwe will be nationalized and the owners paid in Zimbabwean dollars. 25X1
These measures and other minor restrictions are projected to boost the availability of foreign exchange by about $215 million this year. 25X1

The moves were prompted by Zimbabwe's rapidly deteriorating balance of payments, which has resulted from a 30-percent fall in exports since 1981, heavy short-term debt repayments, reduced foreign aid, and a growing bill for imported corn after three years of devastating drought. Zimbabwe will continue its policy of allowing overseas remittances of up to 50 percent of dividends on investments made since 1 September 1979. The new measures almost certainly will further dim prospects for new foreign investment. 25X1

Communist

China's Farm Policies Relaxed

Beijing has issued a series of regulations that further liberalize current policies allotting farmland to individual peasant families. Farmland leases have been lengthened from three years to 15 years in an effort to encourage investment by farmers. Peasant families will be encouraged to specialize in growing one or two marketable commodities. They also will be allowed to sublease their land and move to towns to engage in privately owned service and transport activities. 25X1 25X1

It is clear that Beijing wants less government control and more personal responsibility in all sectors of the rural economy. The formation of individual transport enterprises will help augment the inefficient system and, if developed properly, eventually could lessen the demand for imported grain. Many provincial- and local-level officials oppose a further relaxation of government control, however, and implementing the new policies will be slow and may even be ignored in some areas. Beijing has tried to prepare for such opposition by including regulations making officials more accountable for promoting local economic growth. 25X1

Soviet Housing Construction

According to data published in a leading Soviet statistical journal, the USSR revised upward its 1983 housing construction goal, suggesting that the Andropov regime's commitment to improving housing went beyond lipservice. 25X1 Residential construction reached the higher target, one of the few times in the past 20 years the housing goal has been met. It was the fourth straight year in which rural homebuilding increased but the first time in several years that urban homebuilding rose. The 1984 plan calls for construction of 109 million square meters of housing—less than actually constructed in 1983. The Soviet leadership is accenting expansion of private homebuilding to help relieve the housing shortage, particularly in rural areas. Large boosts in sales to the public of building materials have been planned to encourage private construction. 25X1

Czechoslovakia Encourages Private Hydroelectric Power Generation

Czechoslovakia's tightening energy situation is forcing the normally conservative regime to try innovative methods to boost domestic energy production. According to a recent press article, private individuals and socialist organizations will receive incentives to produce hydroelectric power in excess of their own requirements. Electricity produced by these individuals or organizations must be sold to the state power company at fixed prices for up to 200,000 kWh. 25X1 Private producers can earn up to $9,000—approximately three times the average industrial wage. In addition, these earnings are tax free, and the state will subsidize up to four-fifths of the purchase price of new generator equipment. The program will at best contribute only marginally to overall energy supplies; however, because of limited hydroelectric potential in the country, hydroelectric power provided only 6 percent of electric power production in 1982. 25X1

International Financial Situation: Status of Argentine Debt Talks [redacted] 25X1

This article is part of our series focusing on the economic and political aspects of the international financial situation. [redacted]

Buenos Aires has become increasingly tough in statements about its negotiations with creditors, publicly announcing it will not meet the 31 March deadline for paying overdue interest and reacting negatively to private proposals to resolve the impasse. If the 31 March date passes without payment, over one-half of all US bank loans in Argentina—which total some $8.7 billion—could be classified by the banks as nonperforming. [redacted]

Despite the rhetoric and the fact that Argentina is—among LDCs—best able to cope with a repudiation of its debt because of self-sufficiency in energy and food, we believe it will not choose to do so. In fact, the available evidence indicates the Argentines will continue negotiations with banks and are planning to send a delegation to the IMF in April. [redacted]

A Rise in the Rhetoric

Over the last month, Buenos Aires, particularly Economy Minister Grinspun, has turned up the rhetoric several notches in discussions over foreign debt:

- In mid-March, according to Embassy reporting, Economy Minister Grinspun reacted harshly to a US communique suggesting Argentine action to prevent declines in earnings for some US banks, and for the first time he indicated that Buenos Aires might move to lead a debtors' coalition.
- Grinspun reemphasized to US Embassy officials that Buenos Aires has insufficient reserves to pay overdue interest unless banks disburse new loans and added that the social and political costs of depleting Argentina's liquid reserves to cover interest arrearages are unacceptably high. 25X1
- Grinspun warned that the classification of Argentine loans by the United States as substandard [1] would be seen as an aggressive act and that any legal action against Argentina by bankers would force Buenos Aires to call immediately for a unified Latin American front to resist bankers.
- Grinspun stated publicly this week at the Inter-American Development Bank meeting in Uruguay that Argentina will not pay past-due interest by 31 March. [redacted] 25X1 25X1

Chances for Solution

Bankers are continuing to hold up disbursement of $1 billion of a $1.5 billion loan until Argentina reaches an agreement with the IMF on a letter of intent. Nonetheless, the US Embassy reports that Grinspun still expects banks to make a disbursement of the funds before the 31 March US regulatory deadline just as they did last quarter in the absence of a Fund accord. Non-US banks in the consortium, however, are holding out for an IMF pact [redacted] 25X1 25X1

The US Embassy reports that Argentina has made some progress toward an IMF accord but that it will not meet the 31 March deadline. [redacted] 25X1

[1] Once a bank classifies a loan as nonperforming, US regulators may classify the loan as substandard, which means that banks have to set aside reserves. [redacted] 25X1

Argentine Economic Vulnerabilities

We believe Argentina's greatest short-run economic vulnerability is to cutoffs of key industrial imports, especially those from industrial countries. Although the Argentines could absorb large import cuts, UN trade data reveal several commodities that are consistently imported in large amounts. The Argentines have been large importers of chemicals, plastics, steel products, and high-technology goods since 1979. Most of these items come from the United States, Europe, and Japan. [redacted]

In our opinion, the Argentines are less vulnerable to sanctions against their exports as was shown by their ability to circumvent European trade measures during the Falklands conflict. 1982 trade data indicate that nearly 65 percent of Argentina's $7.6 million 1982 exports were foodstuffs. Their agricultural commodities are shipped worldwide, with the USSR and European Community being sizable markets. About 25 percent of Argentine exports were manufactured products, much of which was sold to the United States. The United States imports large quantities of Argentine petroleum products, steel, leather, and chemicals. [redacted]

From a longer run perspective, however, the Argentine nuclear, arms, and industrial sectors might be dealt some setbacks if sanctions are applied. For example, Argentina depends on Swiss heavy water for its nuclear program, European ships and submarines for its Navy, and Western advanced manufacturing technologies to boost productivity in its industrial and energy sectors. [redacted]

[redacted] there is some recent evidence that the Argentine bank advisory committee is seeking a compromise to prevent an impasse. Banks have stated a willingness to disburse one-half of the frozen $1 billion loan if Argentina sends a letter of intent to the IMF and agrees to pay back the $500 million along with an additional $110 million out of reserves; the banks seem to have relaxed their demand for an in-place IMF pact. This move would bring interest payments current through early January and remove the need for banks to downgrade their loans. The remaining $500 million would be disbursed when the IMF Executive Board approves an Argentine stabilization program, and Argentina would put up another $100 million at that time. Given the lateness of the hour, however, a compromise may not be reached in time. [redacted] 25X1

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The Immediate Implications

If the 31 March deadline passes without payment, US banks probably will place about half of their Argentine loans in a nonperforming status, a move required by US banking rules. Such an action would depress bank earnings only slightly because many banks already have set aside reserves for such an eventuality. [redacted] 25X1 Having to place their loans in a nonperforming status, nonetheless, is likely to cause some deterioration in bankers' attitudes toward Argentina. They may become more intransigent in future negotiations, which would make it more difficult for Argentina to settle past-due payments and reach an IMF letter of intent by the end of June, Buenos Aires' deadline for concluding its international financial negotiations. [redacted] 25X1 25X1 25X1

From the standpoint of Argentina, the classifying of US loans as substandard may be perceived by the Argentines as an act of "economic aggression." Grinspun has indicated that such an action would lead Argentina to call immediately for a unified Latin American front against bankers. Although this course of action seems unlikely, we believe he is trying to avoid a public perception in Argentina that the government is caving in to foreign creditor demands. He may feel pressed to lead the Argentines to take some rash action, such as a temporary postponement of negotiations, if US loans are reclassified. [redacted] 25X1 25X1 25X1

The Longer Run

Despite the recent Argentine hardline rhetoric, the available evidence to date suggests Buenos Aires wants to continue to work toward a solution:

- President Alfonsin has not participated in the increased hardline rhetoric. [redacted] 25X1

- Finally, Buenos Aires has not taken steps, such as moving of assets to safehavens, that would indicate a plan to "close its economy."

Argentina's public posturing will cause some deterioration in its relationship with creditors. Nevertheless, we believe the probability remains low that Argentina will pursue more radical actions, such as declaring an extended moratorium on principal and interest, or that some creditor banks will seek to attach Argentine assets. [redacted] 25X1

Even if the worst is avoided, we believe the current problems in Argentina may have wider implications. [redacted] 25X1 Other Latin American countries are closely monitoring the developments in Argentina. We believe that the Governments of Brazil and Mexico in particular are concerned that Argentina's behavior could affect their own creditworthiness. [redacted] 25X1

[redacted] 25X1

International Financial Situation: Trade Surplus of Key LDC Debtors Triples

25X1

This article is part of our series focusing on the economic and political aspects of the international financial situation. 25X1

We estimate that the aggregate trade surplus of 15 key debt-troubled LDCs [1] rose to nearly $43 billion in 1983, up from $15 billion in 1982 and $2 billion in 1981. A sharp drop in imports was the underlying factor behind the trade balance improvement. Exports declined for a third consecutive year, preventing an even further increase in the surplus. For 1984, we expect the key LDC debtors to sustain their surpluses. A further sharp improvement is unlikely because the steep decline in imports may have bottomed out and only modest export gains are expected. 25X1

Imports Decline in 1983

Imports of the 15 debt-troubled LDCs plummeted last year. For these countries, imports fell $31 billion in 1983—a drop of 28 percent from 1982 and 41 percent from the 1981 peak. Total foreign purchases of the oil-exporting debtors—Mexico, Ecuador, Indonesia, Nigeria, and Venezuela—fell 37 percent. Venezuela reported the steepest decline—an estimated 50-percent drop—followed by Mexico and Nigeria with declines of 44 percent and 41 percent, respectively. Among the remaining LDC debtors, Argentina, Brazil, Chile, and Kenya had 1983 import drops ranging from 16 to 26 percent. Since 1981, foreign purchases by Argentina and Chile have fallen by more than half. Only Costa Rica and Zaire managed to increase their imports in 1983. 25X1

Despite the sharp overall drop in 1983, the two-year decline in imports may finally be ending. Quarterly data for 1983 show imports mostly unchanged in the second half from the low point reached in the second quarter. The leveling off in imports may signal that most of the LDC debtors have pared imports as much as is feasible. Among the key debt-troubled countries, the import trend varied widely over the course of the year. Argentina, Indonesia, Peru, and the Philippines cut imports throughout the year while Chile, Nigeria, and Venezuela registered strong fourth-quarter increases. Mexican imports recovered slightly in the second quarter and remained at that level the rest of the year. 25X1

Exports Continue To Decline

Exports for this group of debtor LDCs performed poorly in 1983, despite a midyear rise in primary commodity prices and increased imports by the industrial countries. Total exports fell 3 percent in 1983—about $4 billion—on the heels of an 8-percent drop in 1982. A plunge in oil exports early last year was largely responsible for the overall 1983 decline. Exports of the five oil-exporting debtors fell by more than $5 billion in 1983. Most of the remaining debtors turned in unimpressive export performances. Even with a record wheat harvest, Argentina managed only a 3-percent export gain. Only Brazil reported a substantial gain, with a $1.6 billion or 8-percent increase. 25X1

Net Result: Trade Surplus Grows

Despite the generally poor export performance of these debtor LDCs, sharp import cuts led to a huge rise in their aggregate trade surplus to nearly $43 billion. In the last three quarters of 1983, the trade surplus ran at about a $47 billion annual rate. The five oil exporters saw their surplus rise to $37

[1] The 15 countries we examined are Argentina, Brazil, Chile, Costa Rica, Ecuador, Indonesia, Ivory Coast, Kenya, Mexico, Morocco, Nigeria, Peru, the Philippines, Venezuela, and Zaire. 25X1

Trade Trends in Key Debt-Troubled Countries [a]

Million US $

	1981	1982	1983				
			Total	I	II	III	IV
Argentina							
Exports	9,030	7,620	7,880	7,740	7,340	7,500	8,950
Imports	9,530	5,390	4,530	4,300	4,860	4,800	4,140
Balance	−500	2,230	3,350	3,440	2,480	2,700	4,810
Brazil							
Exports	23,280	20,210	21,860	20,890	23,000	22,320	21,240
Imports	24,140	21,090	16,760	17,550	16,340	17,040	17,040
Balance	−860	−880	5,100	3,340	6,660	4,200	4,200
Chile							
Exports	3,980	3,810	3,870	3,670	4,160	3,890	3,750
Imports	6,400	3,560	2,790	2,820	2,680	2,670	2,970
Balance	−2,420	250	1,080	850	1,480	1,220	780
Costa Rica							
Exports	960	870	860	790	800	990	850
Imports	1,210	860	960	900	980	970	1,000
Balance	−250	10	−100	−110	−180	20	−150
Ecuador							
Exports	2,520	2,150	2,200	2,230	2,310	2,080	2,170
Imports	2,240	1,990	1,470	1,550	1,420	1,310	1,600
Balance	280	160	730	680	890	770	570
Indonesia							
Exports	22,240	22,150	20,970	18,810	22,120	21,270	21,660
Imports	16,710	17,280	13,690	15,350	13,610	13,720	12,080
Balance	5,530	4,870	7,280	3,460	8,510	7,550	9,580
Ivory Coast							
Exports	2,540	2,300	2,170	2,410	1,730	2,300	2,230
Imports	2,390	2,180	2,020	2,110	1,770	2,080	2,140
Balance	150	120	150	300	−40	220	90
Kenya							
Exports	1,140	1,020	800	820	800	760	820
Imports	1,960	1,620	1,200	1,070	1,140	1,280	1,300
Balance	−820	−600	−400	−250	−340	−520	−480
Mexico							
Exports	19,460	21,580	21,170	20,040	21,160	21,860	21,620
Imports	24,120	14,620	8,160	6,550	8,770	8,630	8,680
Balance	−4,660	6,960	13,010	13,490	12,390	13,230	12,940
Morocco							
Exports	2,350	2,060	2,040	2,020	2,050	2,030	2,060
Imports	4,400	4,320	3,620	3,700	3,420	3,800	3,560
Balance	−2,050	−2,260	−1,580	−1,680	−1,370	−1,770	−1,500

Trade Trends (continued) *Million US $*

	1981	1982	1983				
			Total	I	II	III	IV
Nigeria							
Exports	19,230	16,370	14,630	10,080	14,930	17,700	15,830
Imports	17,410	13,230	7,840	8,650	7,080	7,470	8,150
Balance	1,820	3,140	6,790	1,430	7,850	10,230	7,680
Peru							
Exports	3,260	3,260	3,150	2,680	3,250	3,250	3,390
Imports	3,480	3,610	2,440	2,570	2,430	2,400	2,380
Balance	−220	−350	710	110	820	850	1,010
Philippines							
Exports	5,660	4,960	4,900	4,680	4,790	4,970	5,160
Imports	8,450	8,300	7,830	8,230	8,200	7,690	7,190
Balance	−2,790	−3,340	−2,930	−3,550	−3,410	−2,720	−2,030
Venezuela							
Exports	20,980	17,500	15,600	15,030	17,000	15,090	15,290
Imports	12,060	12,720	6,290	8,220	5,130	5,170	6,650
Balance	8,920	4,780	9,310	6,810	11,870	9,920	8,640
Zaire							
Exports	670	570	560	620	560	540	520
Imports	670	480	490	370	610	480	500
Balance	0	90	70	250	−50	60	20
Total							
Exports	137,290	126,450	122,650	112,520	126,000	126,530	125,560
Imports	135,180	111,240	80,090	83,940	78,450	78,550	79,370
Balance	2,110	15,210	42,560	28,580	47,550	47,980	46,190

[a] Exports f.o.b. and imports c.i.f. Quarterly data are seasonally adjusted at an annual rate.

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billion in 1983. The nonoil debtors' more than $5 billion aggregate surplus was the first positive balance in at least a decade. Forty percent of the total trade balance improvement for the 15 countries came from Brazil and Mexico, with each showing a gain of about $6 billion. Nigeria and Venezuela increased their surplus by an average of $4 billion. Only the Philippines, Kenya, and Morocco continued to run a significant trade deficit.

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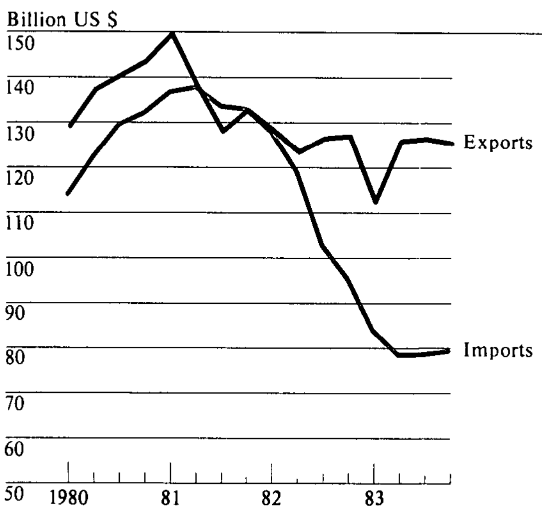
Outlook for 1984

We believe that a further sharp increase in the trade surplus is unlikely. Imports probably will rise slightly in 1984. Many LDC governments face strong domestic pressure for increased imports to relieve shortages and revive economic growth. Continued foreign exchange constraints and a dearth of

Debt-Troubled LDCs: Recent Trade Trends, 1980-84[a]



[a] Quarterly data at an annual rate.

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trade financing, however, will limit the extent of the increase. Exports of these countries should recover slightly this year. Nearly all of the debtor countries devalued their currencies in real terms last year, and the OECD recovery will aid debtor LDC exports; however, surplus stocks of many commodities and the moderate pace of industrial country recovery may prevent a strong export rebound.

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USSR: Economic Performance in 1983

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Soviet economic growth accelerated slightly in 1983, as it had in 1982. We estimate that the increase in GNP last year was about 3 percent, compared with 2.6 percent in 1982 and 2.1 percent in 1981.[1] Better weather, the discipline campaign, managerial changes, and substantial additions of new plant and equipment contributed to the economy's improved performance. 25X1

Soviet consumers benefited from the economy's faster growth. Per capita consumption rose roughly 1.5 percent following a small decline in 1982. As in 1981 and 1982, capital outlays grew more rapidly than consumption and GNP as a whole. 25X1

USSR: Growth of Gross National Product, by Sector of Origin [a] *Average annual percent*

	1976-80 [b]	1981	1982	Preliminary 1983
Gross national product	**2.6**	**2.1**	**2.6**	**3.0**
Agriculture [b]	1.2	0.5	6.1	3.7
Nonagricultural sectors	3.0	2.5	1.9	3.0
Industry	3.2	2.4	2.3	3.5
Construction	1.9	2.1	0.8	3.5
Transportation	3.5	3.8	0.9	2.7
Communications	5.8	5.0	3.2	3.2
Trade	2.9	2.4	0.7	2.2
Services	2.8	2.5	2.2	2.3
Other	2.6	2.1	2.6	3.0

[a] CIA estimates valued at factor cost.
[b] Excludes intra-agricultural use of farm products but does not make an adjustment for purchases by agriculture from other sectors. Value added in agriculture grew at an average annual rate of 0.5 percent in 1976-80, −0.3 percent in 1981, 7.1 percent in 1982, and 2.8 percent in 1983.

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Industry

Industrial production increased by about 3.5 percent, a substantial improvement over the 2.3-percent rise the previous year. Output of over 90 percent of the nonfood industrial items for which the Soviet Central Statistical Administration gives figures was greater in 1983 than in 1982. In 1982, output of only about two-thirds of these products increased, and then only modestly. Sharp increases were registered in chemicals, foods, machine building, and ferrous metallurgy. Production of crude and finished steel increased 4 percent, compared with negligible growth in output in 1982. 25X1

Performance in the critical energy sector was mixed. After three decades of growth, oil production is leveling off. Output grew by about one-half of 1 percent and averaged 12.3 million barrels per day in 1983. Although gas output grew by about 7 percent, raw coal output fell to 716 million tons, 7 million tons below plan. The combined output of major fuels—oil, gas, and coal—increased less than 2.5 percent, compared with the 3-percent rate of growth attained in 1982. 25X1

Agriculture

Because of a larger grain harvest and sizable gains in the livestock sector, farm output rose by over 3.5 percent last year, compared with a 6-percent rise in 1982. These calculations of growth in farm output are subject to considerable uncertainty, largely 25X1

[1] An estimate of 3-percent growth in GNP for 1983 represents a lowering of our earlier figure of 3 to 3.5 percent published in February because of the receipt of additional data.

USSR: Industrial Production Growth [a]

Average annual percent

	1976-80	1981	1982	Preliminary 1983
Industrial production	**3.2**	**2.4**	**2.3**	**3.5**
Industrial materials	2.3	1.9	1.5	3.3
Ferrous metals	0.9	−0.2	0.4	4.0
Rolled steel	0.8	−0.1	−0.9	4.0
Steel pipe	2.6	0.5	−0.4	4.0
Primary energy [b c]	4.0	2.4	2.6	NA
Coal [c]	0.4	−1.7	2.0	−0.3
Oil [c]	4.2	0.9	0.6	0.6
Natural gas [c]	8.5	6.9	7.6	7.1
Electric power	4.5	2.5	3.1	3.7
Chemicals	3.6	4.0	1.8	6.0
Wood, pulp, and paper	−0.6	1.8	0.4	3.3
Construction materials	1.1	1.3	0	3.0
Machinery	5.0	3.2	3.8	4.0
Consumer nondurables	1.9	2.0	1.3	3.3
Food	1.4	2.0	2.8	4.3-5.1
Soft goods	2.7	1.9	−0.5	0.8-1.1

[a] CIA estimates except as noted.
[b] Includes oil, natural gas, coal, hydroelectricity and nuclear electricity, peat, oil shale, fuelwood, and other renewable energy sources.
[c] Calculated from official Soviet data.

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because the Soviets have not published grain crop figures since 1980.[2] Of the crops reported on, output of sugar beets and potatoes was up markedly; cotton and vegetable crops, however, were down from 1982 levels.

A particularly good performance was turned in by the livestock sector. Meat output reached a record 16 million tons, up 4 percent from 1982. Milk output grew by 6 percent to an all-time high of more than 96 million tons, reflecting the mild 1982-83 winter and unusually good forage crops in 1982 and 1983. At the same time, the number of livestock rose to new highs, reflecting both the better harvest in 1983 and the leadership's strong emphasis on the building of herds. 25X1 25X1

Quality foods were in greater supply last year as a result of the improved agricultural performance, although not enough to relax the informal rationing system for some food items. Surveys of private farm markets and state retail stores showed increased supplies of most foodstuffs. Still, private 25X1

[2] Unofficially, the Soviets reported a 158-million-ton crop in 1981.

Although the Soviets have not disclosed the size of the 1982 grain harvest, we recently increased our estimate from 165 million tons to 180 million tons because of additional information received from Soviet press reports on yields and state purchases in 1982.

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USSR: Production of Selected Farm Products

Million metric tons, except where noted

	1980	1981	1982	1983
Crops				
Grain	189	158	180	195
Cotton	10.0	9.6	9.3	9.2
Sugar beets	81	61	72	82
Sunflower seeds	4.6	4.7	5.3	5.1 [a]
Potatoes	67	72	78	83
Vegetables	27.5	27	30	29
Livestock products				
Meat	15.1	15.2	15.4	16
Milk	91	89	91	96.5
Eggs (billion units)	68	71	72.5	74.5
Livestock herds [b]	121.5	122.2	124.3	126.7

[a] USDA estimate.
[b] End of year (1970 = 100).

[redacted] 25X1

farm market prices rose slightly, a sign that the increased supplies of food were not sufficient to meet the additional demand generated by income growth.[3] [redacted]

Transportation

The transportation picture was also rosier in 1983. Total freight turnover increased about 5 percent, with all modes of transport showing marked improvement. Most significant was the turnaround in the performance of the railroads, the backbone of the transport system. Rail freight turnover increased 4 percent after falling over 1 percent in 1982. [redacted]

[3] Prices in collective farm markets in the USSR are allowed to fluctuate in accordance with supply and demand. [redacted]

USSR: Growth of Freight Turnover [a]

Percent

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	1981	1982	1983
Total	**4**	**1**	**5**
Railroads	2	−1	4
Rivers	4	3	4
Highways	6	1	2.5
Oil pipeline	4	3	4
Gas pipeline	14	13	12

[a] Based on official Soviet data in metric ton-kilometers.

[redacted]

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Foreign Trade

We estimate that the value of Soviet imports grew about 5 percent and the value of exports approximately 7 percent in 1983, with most of the gains coming from increased trade with Communist countries. Moscow's hard currency current account position is estimated to have remained at about the 1982 level—a surplus of about $4 billion. The Soviets boosted oil exports last year to counteract the fall in oil prices, increased arms deliveries to less developed countries, and restricted the growth of imports. [redacted]

Reasons for the Better Performance

The somewhat improved economic performance owes much to last year's return to normal weather, which helped boost farm production. In addition, a relatively benign winter and spring with warmer-than-normal temperatures and below-normal snowfalls benefited nonagricultural sectors. The more favorable conditions bolstered industrial production by permitting some rebuilding of stocks of fuels and other inputs less in demand when the weather is mild. The weather also helped ease transportation snarls, which, in turn, relieved industrial bottlenecks. [redacted]

Another factor that contributed to improved performance was the substantial addition to new productive capacity in the last two years. The new plant and equipment brought on line increased by a hefty 5.2 percent in 1982 and at roughly the same rate in 1983. [redacted]

Policy and personnel changes introduced by the new regime also played a part in the more rapid growth. Andropov's discipline campaign appears to have compelled greater effort from both labor and management. Management changes may have been a particularly significant factor in the turnaround in rail transportation, a sector which seems to have suffered from especially lax leadership during the Brezhnev era. The new Minister of the Railways, Nikolay Konarev, not only tightened discipline, but also instituted several new programs—such as enlisting industrial enterprises and other shippers in the repair of damaged freight cars—that apparently paid some dividends. [redacted] 25X1

Resource Allocation

Capital investment rose by 4 or 5 percent last year, thereby absorbing a larger share of GNP, as it had in the first two years of the 11th Five-Year Plan (1981-85). For 1981-83 as a whole, average annual growth in new fixed investment was about 4 percent, compared with about 2.7 percent for GNP. 25X1
The 11th Five-Year Plan, however, called for slower growth in investment than in overall economic growth. The rationale was that lagging investment growth would be offset by rising capital productivity based on more efficient use of capital and speedier technological progress. The consistently faster increase in investment than in GNP suggests that this strategy was abandoned or ignored. Planners also may have been unable to control investment from the center, particularly new construction activity. [redacted] 25X1

Although growth in consumption continued to increase at a slower rate than GNP, the consumer fared better in 1983 than in 1982, with per capita consumption rising roughly 1.5 percent. Serious imbalances in consumer markets continued in 25X1
1983, however, reflecting the mismatch between output mix and consumer demand. In addition, mostly because of previous price increases, inventories of some nonfood goods rose, causing Moscow to reduce prices on selected consumer items three 25X1
times last year. [redacted] 25X1

Soviet data yielded no direct information on allocation of resources to the third major end-use component of GNP—defense. The official defense budget for 1983 did not increase over the previous year, but this figure is of little significance; it is far lower than actual defense expenditures and incompatible with known Soviet force levels and military programs. [redacted] 25X1

[redacted] 25X1

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USSR: Economic Plan for 1984 25X1

The optimistic economic goals announced at the Supreme Soviet meeting in December could be accomplished if the weather continues favorable and if a continuation of the discipline campaign exacts even greater efforts from Soviet workers 25X1

The 1984 plan is conservative. It points to no significant changes in resource allocation policy and contains no initiatives for altering the way the Soviet economy is run. The 1984 plan is unlikely to be affected significantly by Andropov's death. With 1984 already well under way, Chernenko is not in a position to introduce major changes this year and has not indicated any disposition to do so. 25X1

USSR: GNP Growth *Average annual percent*

1981	2.1
1982	2.6
1983	3.0
1984 Plan	3.0
1981-85 Plan	4.0

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1984 Targets

Soviet plans imply a GNP growth rate in 1984 of about 3 percent. Planned growth in industrial production is 3.8 percent—roughly equal to our estimate of actual growth of about 3.5 percent in 1983. Of those sectors for which goals have been published, the key machine-building sector is scheduled for the most rapid growth—5.8 percent. 25X1

In the energy sector, the targeted rates of growth for oil and natural gas are 1.3 percent and 7.8 percent, respectively. Both goals are probably overly ambitious—oil output grew only about one-half of 1 percent in 1983. Indeed, production from the key Tyumen' region failed for the first time last year to reach planned output. Annual increases in natural gas production of about 7 percent have been more typical in recent years. The 723-million-ton goal for coal production is the same as the 1983 target. Coal production declined from 718 million tons in 1982 to 716 million tons last year. 25X1

Agricultural output is to rise by roughly 5 percent, above the 3.7-percent gain calculated for 1983. Plenty of soil moisture so far this year bodes well for both the winter grain crop and for spring planting. The mild winter weather experienced so far also holds out the prospect of an improved performance by the livestock sector in 1984. But favorable weather conditions must continue if agricultural output this year is to exceed the 1983 level. 25X1

The plan calls for growth in rail freight turnover to slip to below 2 percent from 4 percent in 1983. This projected decline, despite plans to maintain the 1983 GNP growth rate, probably reflects Soviet intentions to markedly improve efficiency of the railroads by reducing the amount of "irrational" hauls through new incentives, decentralizing management, and stepping up the pace of modernization. In addition, it could indicate continuing efforts to raise the share of freight carried by other modes of transport. 25X1

Prescriptions for Meeting Goals

The December speeches by the party leaders and the plan itself listed continued general goals— 25X1

productivity, greater resource conservation, "a decisive turn" toward scientific and technological progress—but offered little on how these requirements are to be met. Nor have Chernenko's speeches and comments since he replaced Andropov given any guidance on how this is to be done.

The speech delivered on behalf of Andropov at the December Central Committee meeting repeated previous appeals for stricter worker and management discipline and increased efficiency in the use of labor, plant and equipment, and raw materials. It called for the growth in labor productivity to exceed by a percentage point the targets laid down in the plan itself (3.4 percent for labor productivity in industry, 3.3 percent in construction, and 8.5 percent in socialist agriculture—far above what the Soviets have actually achieved in recent years). Andropov's speech likewise urged an additional cut in production costs of half a percentage point beyond the cost reduction targets in the plan. The purpose in tacking on these additional requirements is perhaps to dramatize the need for greater efficiency.

Demands for higher labor productivity are rising as the labor supply squeeze intensifies. Total civilian employment increased by 0.6 percent in 1983—0.5 percent in industry—compared with an average annual rate of growth of 1.2 percent during 1976-80 and of 1 percent during 1981-82. The plan indicates even slower growth—about 0.4 percent—in 1984.

The plan also lays down tougher conservation goals for energy, metals, and raw materials, but they are unlikely to be reached. Enterprise managers probably will concern themselves foremost with meeting output targets.

Andropov's December report urged more rapid "scientific and technological" advances. But nothing in Andropov's remarks suggested an intent to make significant changes in the Soviet planning and incentive system, which discourages innovation and retards technological progress.

Little Change in Policy Implied

In his short tenure, Andropov repeatedly and candidly acknowledged that the USSR was plagued by serious economic problems. Despite his demands for bold action to deal with them, he basically continued Brezhnev's policies, although Andropov's mark is evident in selected areas—the discipline campaign, for instance. In 1984, under Chernenko, continuity will apparently remain the hallmark of the USSR's economic program. For the most part, the 1984 plan merely reemphasizes programs and initiatives inherited from the Brezhnev regime.

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Resource Allocation. The 1984 plan calls for a 3.9-percent increase in fixed capital investment. Because investment growth has run well ahead of plan each year since the 11th Five-Year Plan began, however, the actual increase in investment in 1984 may well be greater. The 1984 plan does not indicate major changes in the allocation of investment resources among the major claimants. Finance Minister Garbuzov indicated that capital investment will go "in the first place" for projects in energy and the agro-industrial complex, metallurgy, machine building, chemicals, transport, and consumer goods. With the exception of consumer goods and chemicals, these sectors are the same ones singled out for priority attention in the 1981-85 Plan.[1] Investment in energy is to grow by 11 percent this year. This is in line with the five-year increase of 50 percent originally targeted for energy in the 11th Five-Year Plan.

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Several of the planned goals imply a 4-percent increase in consumption in 1984, compared with a rise of almost 2.5 percent in 1983. Fulfillment of the consumption plans will depend in part on availability of foodstuffs, and, therefore, on agricultural performance. The planned acceleration in growth of consumption is to be accompanied by a continuing decrease in wage growth to help contain

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a buildup of unspent purchasing power should targets for consumer goods and services not be met. [redacted]

No targets for military spending are given except in the meaningless defense budget, which is essentially the same as the ones published for the last three years. The only reference to defense in the Andropov speech presented to the party plenum last December stated that "everything necessary has been done to maintain the country's defense capacity at a proper level." [redacted]

Agricultural Policy. Soviet agricultural policy appears unchanged. No new plans for crop production were promulgated, and support for the Food Program apparently will be continued. The agro-industrial complex is to receive a huge share of total investment—about one-third—with large increases going to support activities such as rural transportation, storage facilities, and production of agricultural machinery and fertilizer. [redacted]

Foreign Trade Policy. The foreign trade plan suggests that Moscow is still bent on increasing trade with its Warsaw Pact partners and other Communist countries at the expense of trade with the West. In his annual report to the Supreme Soviet, Gosplan Chairman Baybakov said that the volume of trade with "socialist countries" would increase 10 percent and would reach 61 percent of total Soviet trade turnover. It amounted to 54 percent in 1980. He implied that trade with capitalist countries would drop about 10 percent. Aside from the desire to reduce the reliance of CEMA countries on the West, an important factor in Moscow's policy is a longstanding desire to limit its borrowing from the West. The regime also may be anticipating some decline in its hard currency earnings this year because it expects reduced earnings from oil and arms exports. [redacted]

Economic Reform

The 1984 plan and the accompanying comments by Soviet leaders—including those by Chernenko since he became General Secretary—indicate that the leadership does not intend to go beyond the

USSR: Average Annual Growth in Foreign Trade Volume [a] *Percent* 25X1

	1981	1982	1983 [b]	1984 Plan [c]	1981-85 Plan
Total trade	**4.2**	**8.2**	**5**	**1**	**4.0**
With Communist countries	2.3	5.3	5	10	5.6
With non-Communist countries	7.8	10.8	4	−10	2.3

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[a] Calculated from Soviet data expressed in constant prices.
[b] Estimated.
[c] Soviet statements are unclear as to whether 1984 plan figures are stated in constant or nominal terms.

[redacted] 25X1

modest economic reforms already instituted or announced before December. The Andropov speech to the Central Committee, for example, called for continuation of the drive to expand the use of small labor brigades in industry, construction, and agriculture. In addition, it strongly endorsed the "industrial experiment"—announced in mid-1983 and given mounting publicity since then—that gives increased autonomy to enterprises in five industrial ministries. The experiment began 1 January 1984. Both the brigade system and the main elements of the five-ministry experiment are essentially continuations of programs and experiments introduced under Brezhnev. [redacted] 25X1

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Andropov undoubtedly faced both economic and political obstacles—such as a conservative ideology and an entrenched bureaucracy—in his efforts to introduce change. In addition, however, other factors may help explain why Andropov did not introduce a more dynamic economic program: 25X1

- The somewhat improved performance of the economy in 1983 may have increased Moscow's confidence that actions already taken had been sufficient to ensure more rapid growth in the years ahead.

- Andropov may have been mustering his resources for the 1986-90 planning period.

- Andropov may have been forced to slow the pace at which he was proceeding in exchange for gaining the appointment of "his team" to key party and government posts.

- Failing health also may have prevented Andropov from pushing for more vigorous measures.

For the moment, the watchword under the Chernenko leadership is *continuity*. It is difficult to know what approach to the economy the new General Secretary might take in the longer run, particularly since his past statements do not suggest a clearly defined or comprehensive economic philosophy or strategy. He has been aligned with those urging more attention to consumer welfare and corresponding increases in the availability of consumer goods. He thus might opt, in the 12th Five-Year Plan, for some redirection of investment toward consumer goods and services sectors. He has also advocated regional administration of specific economic programs, such as the Food Program. He apparently prefers regional to ministerial organization. In 1982 he attacked the autonomy of the ministries, which he said "eats away like rust at the economic mechanism." There is nothing in his background or past pronouncements to indicate an inclination toward bold systemic change that would significantly reduce centralized planning or management.

The first major Central Committee resolution published by the new regime suggests a hostile attitude toward challenges to basic elements of the economic system. The resolution chastises the Institute of Economics of the Academy of Sciences for superficial and misguided research and analysis and urges the Institute to undertake work with more practical application. The attack on the Institute appears to be a veiled, high-level warning to academic economists generally to cease openly proposing radical and sweeping changes. The resolution could signal an end to the candid, far-ranging public discussion of economic issues encouraged by Andropov, at least in his early months as General Secretary.

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India: Economic Ties With the Soviet Union [redacted] 25X1

Stung by sharp cutbacks in Soviet purchases of Indian goods in late 1982 and 1983, Indian exporters and economic analysts have begun to take a more careful look at economic ties with the USSR. Many Indians now believe that Indian industry has outgrown the need for less sophisticated and low-quality Soviet products and that agreements requiring a balance in bilateral payments are becoming a burden. We believe, however, that mounting payments for Soviet military equipment will soon stimulate Indian exports to the USSR. Arms trade will help solidify economic and political links with Moscow but may strain India's overall balance-of-payments position. [redacted] 25X1

Economic Relationship

India's economic relations with the Soviet Union are governed by agreement to balance all bilateral payments. All transactions are made in Indian rupees through the Indian banking system, eliminating the need for hard currency. [redacted] 25X1

To avoid large or persistent payment imbalances, the two governments negotiate annual and five-year targets for merchandise trade. The actual value of imports and exports depends on separate contracts signed and implemented by public- and private-sector organizations. Trade targets are not always met, and a payments balance is not always achieved. [redacted] If the USSR runs a surplus, Moscow invests in Indian Government securities. [redacted] 25X1

Bilateral trade patterns have changed markedly since the mid-1950s, when the agreements began. Machinery and equipment once accounted for about 75 percent of Indian purchases. Now that New Delhi has built up its heavy industrial base, local manufacturers are capable of supplying much of the country's requirements. Officials and businessmen frequently spurn Soviet capital goods in favor of better quality equipment and more advanced technology from Western suppliers. [redacted] 25X1

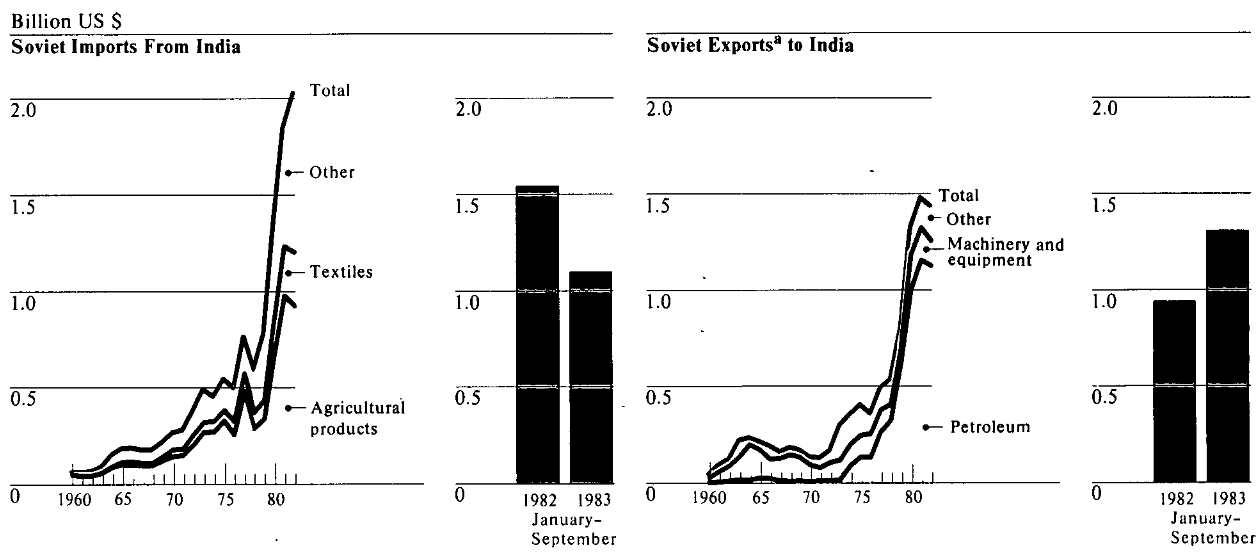
The Political Impetus for Trade

India's economic agreements with the Soviet Union provide a symbol of mutual cooperation as well as a mechanism for regulating trade. In our judgment, most Indians view rupee payments arrangements as evidence of Soviet support. For Moscow, the political benefits of being seen as a friend of India probably outweigh any economic advantages or disadvantages. [redacted] 25X1

The political overtones of trade induce both governments to try to achieve the required payments balance by expanding imports or exports. A planned cutback would be interpreted by the Indian press—and by us—as evidence of a souring political relationship. [redacted] 25X1 25X1 25X1

A new phase in New Delhi's economic relations with Moscow began in the mid-1970s, when the Soviet Union agreed to sell India more petroleum, including some Middle Eastern crude. The scope for growth in Indian exports is now determined by

India: Trade With the USSR, 1960-83



[a] Most military sales are excluded.

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purchases of crude oil and petroleum products, which account for 80 percent of New Delhi's imports from the Soviet Union.

A surge in Indian exports set the stage for recent problems, according to press reports. Soviet trade organizations began a buying spree in India in 1981 when they were faced with hard currency shortages but ample rupee earnings. Indian firms and subsidiaries of multinationals expanded output of manufactured consumer goods in order to cater to Soviet demand and take advantage of export subsidies and production incentives offered by the Indian Government. By 1982, however, the price of crude oil began slipping, and the Indian trade surplus grew much larger than needed to cover military and civilian debt service. At its peak, sometime in late 1982 or early 1983, the payments imbalance probably exceeded the equivalent of $500 million. India was lending large sums of money to the Soviet Union.

The huge payments imbalance provoked painful corrective measures. Indian exporters bore the brunt of bringing the account into balance. According to the Indian press, sales of cashew nuts, pepper, and tobacco were sharply reduced. Industries that had expanded to serve the Soviet market—especially detergents, cosmetics, pharmaceuticals, and woolen knitwear—were forced to curtail output. Exports of cotton textiles also slumped, though a prolonged strike in Bombay mills contributed to the decline.

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Reappraisal of Economic Ties

Disruption of exports has led Indian businessmen and economic journalists to reassess the gains from trade with the Soviet Union. The tenor of extensive

press comment is that India got a good deal in the past but may be handicapped in the future by the requirement to balance bilateral payments. [redacted]

Additional exports are the principal benefit India receives from its economic agreements with the Soviet Union, in our judgment. Moscow accepts low-quality or high-cost products, partly produced from surplus capacity, that are of little interest to other countries. Indian suppliers with weak marketing skills especially appreciate the ease of selling to the Soviet Union. We doubt that Moscow would buy so much from India if it were not bound by an obligation to balance bilateral payments. [redacted]

In return, India imports goods that policymakers in New Delhi consider essential—aid-financed equipment to develop public-sector industries at first and now petroleum. The USSR offers cheap credit for military purchases and assists India with domestic military production. New Delhi has sometimes turned to the Soviet Union after access to Western supplies or aid was curtailed. [redacted]

We believe the disadvantages of the trade arrangement with the Soviet Union have usually been less evident. India may pay slightly higher prices for nonmilitary goods, according to academic studies. In addition, public-sector officials are alert to the danger that industrial expansion based on inferior Soviet equipment could lead to technological obsolescence. Finally, Soviet purchases of particular commodities vary widely from year to year. Since 1982, exporters have become acutely aware of the risk of a sharp decline in sales. Producers who cater primarily to the Soviet market are especially vulnerable. [redacted]

The balance of gains and losses from bilateral economic agreements is now shifting to India's disadvantage, in the view of many businessmen and economic journalists. A consensus now emerging in the Indian business press holds that petroleum imports cannot sustain continued growth in bilateral trade, and India does not need other products the Soviet Union is willing to offer. Yet, the obligation to balance bilateral payments means that exports to the Soviet Union cannot grow if imports stagnate or fall. Therefore, many in the business community

India: *Million US $*
Annual Military Import Payments 25X1

	Total	USSR	Other Suppliers
1975-79	175-325	150-225	25-100
Current	500-600	300-400	200
1985-89 [a]	800-1,500	500-1,000	300-500

[a] The wide range of our estimates reflects uncertainty about the pace of future deliveries and lack of complete information about prices and credit terms. 25X1

[redacted] 25X1

argue that New Delhi should break the link between imports and exports by revising economic agreements with the Soviet Union and settling any payment imbalances in hard currency. [redacted] 25X1

Outlook

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The Indian business community probably does not need to worry about a loss of Soviet markets. In our view, the overall trading relationship will be sustained by sharply rising Indian military payments, which will generate new export opportunities. By our estimates, agreements signed since early 1980 and those now being negotiated will greatly increase annual payments for military purchases over the next several years, perhaps by as much as $700 million. In addition, interest and amortization payments on past equipment deliveries will continue. [redacted] 25X1

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If our higher estimates of military payments prove correct and if petroleum exploration efforts continue to be unsuccessful, New Delhi could have difficulty balancing the bilateral account through increased exports. In that event, it could revise the bilateral payments agreement or shift oil purchases to the world market. Such a shift would increase India's already sizable hard currency deficit. [redacted] 25X1

The rise in military payments will coincide with increased payments to the IMF and to commercial

Arms Imports

We estimate that India has ordered more than $14 billion in arms since 1970, nearly $10 billion since Prime Minister Gandhi's return to power in 1980. The more recent orders indicate, in our view, a strong government commitment to building a more modern and powerful military, concern about deficiencies in Indian defense industries, and a reaction to US arms sales to Pakistan. [redacted] 25X1

Although New Delhi remains willing to purchase limited quantities of selected high-technology arms from the West, 70 percent of recent purchases have been from the Soviet Union. Imports have included aircraft, helicopters, missiles, armored fighting vehicles, artillery, and warships. [redacted] 25X1
[redacted] *the Indians are negotiating with the Soviets for the procurement of a wide variety of additional arms and increased defense cooperation, which we value at several billion dollars. Moscow is offering New Delhi some of its most advanced military hardware and technology at favorable prices and repayment terms.* [redacted] 25X1

bankers and with stagnation in concessional aid receipts. We believe that Indian officials will blame any balance-of-payments strains on reduced US support for Indian borrowing from international financial institutions rather than on their own military purchases. [redacted] 25X1

[redacted] 25X1

South Africa: Implications of Falling Gold Production[1] [redacted] 25X1

The confidence of white South Africans has long been sustained by a sense of the fundamental economic strength of their country, based on the world's richest endowment of gold and a long history of economic growth. The implications of the long-term decline in South African gold production since 1970 suggest that such confidence is not well founded. [redacted]

In our judgment, South Africa's conservative economic policymakers will continue to prefer short-term financial stability to riskier policies aimed at boosting growth over the longer term. This means that they will continue to manage demand for imports at levels that can be financed by gold earnings, which are likely to be volatile. As a result, we think the South African economy will grow at little more than 2.5 to 3.0 percent annually through the rest of the 1980s. [redacted]

Slow growth will limit the resources available to the government and increase feelings of insecurity among South African whites. We doubt, however, that South Africa's economic predicament will give Washington much leverage over the way Pretoria conducts its domestic or regional policies. [redacted]

Background

Gold mining has been the major factor in South African economic development since the discovery of large reefs of gold in 1886 in the area around which Johannesburg has developed. The more than 30-percent decline in the country's gold output since its peak in 1970 has cast a shadow over Pretoria's economic outlook. Although gold production increased slightly last year and we expect similar rises in 1984 and 1985, annual gold output probably will resume its long-term downward trend thereafter, dipping below 600 tons annually by the early 1990s. [redacted] 25X1

Impact of Declining Gold Production on Economic Growth

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The fall in South African gold production has been a drag on the country's economic growth:

- The decline has shrunk the contribution of mining to real GDP from 18 percent in 1970 to 11 percent in 1983.
- The fall in gold production has limited the amount of foreign exchange available for imports, including capital goods critical to economic growth; earnings from gold sales nevertheless enable South Africa to import at one-and-one-half to two times the level that would be possible without gold. 25X1
- This foreign exchange constraint has induced the government periodically to adopt fiscal and monetary policies that deliberately sacrifice economic growth in order to stifle demand for imports. [redacted] 25X1 25X1

Foreign exchange shortages caused by the fall in gold production would have been much more severe except for steep, speculative increases in the price of gold. Increased earnings from gold sales—from an average of $1.5 billion a year in the early 1970s to $10 billion annually so far in the 1980s—offset slightly more than half of a $16 billion increase in the cost of imports and net services during the same period. [redacted] 25X1

To meet severe current account deficits in 1970-71, 1975-76, and 1981-82, economic policymakers in Pretoria followed essentially the same pattern of behavior each time: initially selling gold from the 25X1

[1] This article summarizes a forthcoming Intelligence Assessment with the same title. [redacted]

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The Outlook for South African Gold Production

According to South African mining experts, most of the easily mined ores in the country were exploited long ago; remaining ores are largely at extreme depths and of low grade. Average yields dropped from 11.2 grams per metric ton of ore in 1970 to 6.4 grams in 1982, and we expect that ore grades will continue to decline. Mining experts do not foresee any major new discoveries.

Production rose slightly last year and will probably do so again this year and in 1985, but we believe this is only a temporary development. The decline in gold prices since 1980 has induced companies to bypass lower grade ores that could have been mined profitably at higher prices in order to concentrate on dwindling veins of relatively high yield ore. In addition, the price surge in 1980 induced several companies to expand their capacity to mill ores and led to the development of one additional mine that is just now coming on stream.

The Mines

The top dozen South African gold mines, which include all of those that produced over 25 tons of gold in 1982, account for nearly two-thirds of the country's gold production. Nine of these are more than 20 years old and beyond their peak productive years, but they are still working fairly rich and extensive ore deposits and should be able to keep producing—albeit at a lower rate—for the next 10 to 30 years. 25X1

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Ore bodies have been substantially depleted and ore grades are falling rapidly in almost all of South Africa's other 28 gold mines. We estimate that at least 12 of these accounting for about one-seventh of total production will be closed by the early 1990s. 25X1

Unless gold prices soon regain high levels—$800 an ounce or more—for a sustained period, we estimate that the level of new investment in South African gold mines will decline. New projects are becoming increasingly expensive to bring into production. Projects scheduled for startup over the next several years consist primarily of extensions to existing mines. 25X1 *Moreover, the depletion of the richest ore reserves is inducing the mining industry to shift its attention from gold to coal, according to the South African Chamber of Mines.* 25X1

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government's stock,[2] then using monetary and fiscal tools—higher interest rates and reduced government spending—that constrained economic growth to reduce demand for imports.

We believe that Pretoria's policy of periodically stifling growth was the principal cause for the decline in the average rate of South African economic growth from 5.7 percent in the 1960s to 2.8 percent since 1970. Moreover, in our judgment, Pretoria's reactions made it all the more difficult for South Africa to adjust to the peaks and troughs that have wrenched the world economy since the early 1970s. 25X1 Even ignoring the past three years—when the South African economy reeled under the combined impact of worldwide recession and severe drought—the average annual rate of South African economic growth (1971-80) was still less than 4 percent. Without the relief that the two gold price surges of 1974 and 1980 provided for the foreign exchange constraints on Pretoria, the rate of South African economic growth during the years 1971-80 would in all likelihood have been less than 3 percent. 25X1

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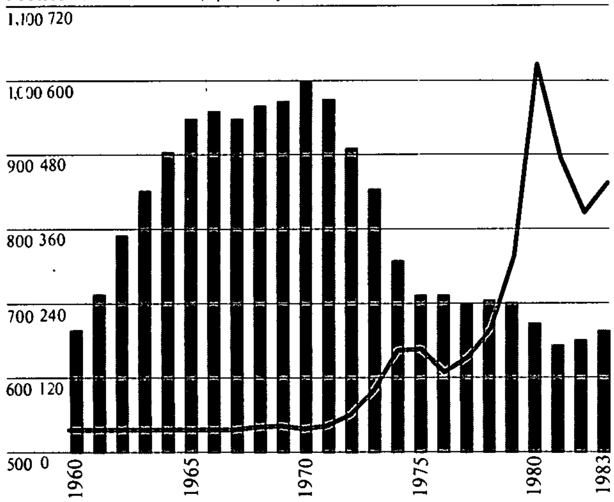
[2] Although Pretoria generally exports its annual production of gold to maintain a reputation as a reliable supplier to the international market, it allows sales to exceed production when necessary to help reduce current account deficits. Pretoria has drawn down its stock of gold in government vaults by 60 percent, that is, 350 tons, since 1970.

South Africa: Gold Production and Prices, 1960-83



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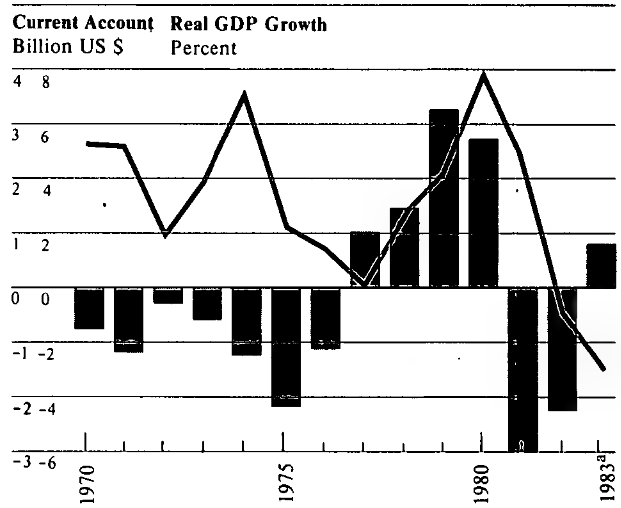
South Africa: Current Account Trends and Real GDP Growth, 1970-83



[a] Estimated.

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South Africa's Options

So long as South African gold production continues to fall, we doubt that Pretoria will be able to avoid payments predicaments in the future. Apart from hoping for large new gold discoveries, which we and South African mining experts believe to be highly improbable, or for large, sustained gold price increases, which would be strictly fortuitous, we believe that South Africa has essentially only two alternatives to its established policy of periodic clampdowns on growth: heavy borrowing from Western banks or trying to accelerate the growth of nongold exports.

The first option—increasing substantially public and private borrowing from Western banks—probably already is a source of concern to economic decisionmakers in Pretoria; South Africa's foreign debt increased from about $7 billion in 1980 to $15 billion in mid-1983, according to statistics published by the Bank for International Settlements. Further increases—particularly large ones that might threaten South Africa's solid international credit rating—are unlikely because:

- They would mark a significant departure from the pattern of economic fine-tuning that the government has carried out successfully since the decline in gold production began.
- They would clash with the Calvinist-based tenets of the government's Afrikaner leaders, who tend to view heavy debt as immoral.
- Heavy foreign debt in the perception of South Africa's leaders would be a potential source of leverage for foreign critics of the South African racial system.

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Policymakers in Pretoria have long recognized that their second and most desirable option would be to increase nongold exports enough to offset the loss of the economic boost that steadily rising gold production once provided. This would help the

South African economy sustain a higher level of growth without a heavy burden of foreign debt or a need for sharp periodic curbs on growth.

Nearly all of South Africa's nongold exports consist of raw and intermediate goods. Six product groups—coal, diamonds, platinum-group metals, metallic ores, ferroalloys, and corn—normally account for about 40 percent of the total. South Africa has found it cheaper and easier to increase exports of raw and intermediate goods than to produce and market finished consumer goods abroad.

The long-term performance of South Africa's nongold exports has been good but not good enough to make up for the combined effects of the fall in gold production and inflation in import prices. The country's nongold exports grew by an average of 20 percent annually during the period 1971-80—about the same rate as that of total export growth in the United States, the United Kingdom, and Japan. This was well behind the export performance of such fast-growing LDCs as Singapore and South Korea, however, which achieved average annual export growth rates of 31 percent and 34 percent, respectively, in the same period.

Moreover, South Africa's nongold exports have declined by more than one-fifth since 1980. This decline—the first in 25 years—resulted from reduced demand because of economic recession in the principal markets for South Africa's nongold exports—Western Europe, the United States, and Japan—and because of severe drought in 1983, which halted corn exports.

We doubt that South African nongold exports will achieve the kind of performance that would make up for the loss of the growth stimulus that rising gold production formerly provided. Although prospects in foreign markets for coal and South Africa's other five major nongold exports are fair to good, they would have to be outstanding to fill the gap created by the probable decline in export earnings from gold.

South Africa: Major Exports *Million US $*

	1970	1980	1983 [a]
Total	**3,651**	**24,455**	**18,725**
Gold	1,617	11,902	8,925
Nongold	2,034	12,553	9,800
Of which:			
Coal	16	932	973
Diamonds	274	1,622	1,184
Platinum group metals [a]	NA	900	700
Metallic ores	132	716	463
Ferroalloys	48	503	358
Corn	75	538	162

[a] Estimated.

In our judgment, the South African Government will continue to restrict economic growth from time to time in order to minimize current account deficits caused by fluctuations in gold earnings. As a result, South Africa's annual real economic growth during the years 1984-90 probably will average no more than 2.5 to 3 percent.

Implications

It has long been an article of faith among observers of South Africa that economic hard times increase the potential for political and social unrest. This argument, however, has not held up well in the face of the actual pattern of racial unrest in South Africa. Although the Soweto riots in 1976 occurred during an economic downturn, they were triggered by noneconomic factors, particularly student grievances over forced instruction in the Afrikaans language. The extraordinary spurt in economic growth in 1980, on the other hand, was accompanied by a notable increase in major acts of protest,

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including an upsurge in strikes, school boycotts, and riots. By contrast, during the severe economic contraction of 1982 and 1983, outbreaks of racial violence were relatively few in number and small in scope.

We believe the potential for major racial disturbances will remain high under almost any economic circumstances. Indeed, racial unrest—including the small-scale labor strife and violent crime that occur practically every day in South Africa—may even become more common and extensive during periods of rapid economic growth, which tend to intensify black frustration and resentment over fundamental social and political disparities that cannot be alleviated by short-term economic gains.

In our view, the long-term leveling off of economic growth that we expect will have some predictable, albeit from the US standpoint, mixed effects:

- The financial burden of extensive military activities, such as those South Africa has undertaken in Angola, and of maintaining administrative control over Namibia will become more onerous.

- Pretoria will also have fewer resources to spend on domestic social and economic reforms.

- Business opportunities for the 400 US firms that have subsidiaries, branches, and affiliates in South Africa will be reduced, although US banks may find increased opportunities for making commercial loans to South Africa.

- Pretoria will likely seek balance-of-payments assistance periodically from the IMF.

- Neighboring southern African countries may seek additional aid from the United States and other foreign donors because of reduced growth in South African demand for imports of manufactured goods (important to Zimbabwe) and for migrant labor (from Lesotho, Mozambique, Botswana, and to a lesser extent Swaziland and Zimbabwe). 25X1 25X1

We doubt, however, that South Africa's economic predicament will give Washington much leverage over the way Pretoria conducts its domestic or regional policies. South African leaders will probably not allow economic constraints to stop them from protecting those things they regard as vital to their country's security or to Afrikaner political control. 25X1 25X1

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